Supreme Court, U.S.
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No. 92-1301

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

JULIAN R. YOUMANS,
Petitioner,
v.
THE PRUDENTIAL INSURANCE COMPANY OF AMERICA,
Respondent.

On Petition for A Writ Of Certiorari
To The United States Court Of Appeals
For The Fourth Circuit

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Should this Court exercise its discretion to grant certiorari to review a fact-specific decision of the Fourth Circuit that merely involves the application of South Carolina law and does nothing more than affirm that the rights of a second mortgagee are subordinate and inferior to the rights of the holder of a prior recorded first mortgage?

II. Should this Court exercise its discretion to grant certiorari to determine whether the Fourth Circuit "reweighed the evidence" when it entered judgment in favor of Prudential as a matter of law?

LIST OF PARTIES

1. Julian R. Youmans, Petitioner
2. The Prudential Insurance Company of America, Respondent. (No parent or subsidiary listed).
3. Hospitality Associates, a South Carolina Limited Partnership.
4. Jeffrey Stoler.
5. Martin Hecht.

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CITATION TO REPORTED OPINIONS IN THE CASE

The decision of the United States Court of Appeals for the Fourth Circuit is reported, without published opinion, at 977 F.2d 575 (4th Cir. 1992). The full text is reproduced in Westlaw and also appears at pages 1-19 of Petitioner's Appendix. The decision of the District Court is not reported.

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STATEMENT OF THE CASE

Introduction

In December of 1984, Hospitality Associates of Charleston, Ltd. ("HAC") purchased the Francis Marion Hotel from Petitioner Youmans for $10,050,000. Respondent The Prudential Insurance Company of America ("Prudential") loaned HAC $6,000,000 secured by a first mortgage for the purchase and Youmans financed a portion of the purchase price with second and third mortgages, which were recorded after and expressly subordinate to Prudential's mortgage.

Paragraph 30 of Prudential's first mortgage contained a provision authorizing Prudential to grant its borrower extensions of time for payment without consent from or notice to Youmans:

> **30. ACTIONS BY MORTGAGEE:**
>
> a. Without affecting the liability of [HAC] for payment of any indebtedness secured hereby or for performance of any obligation contained herein, . . . [Prudential] may, at any time and from time to time, either before or after the maturity of said note, and **without notice or consent**:
>
> * * *
>
> **(ii) make any agreement extending the time or otherwise altering the terms of payment of all or any part of the indebtedness** or modifying or waiving any obligation, or subordinating, modifying or otherwise dealing with the lien or charge hereof.

(emphasis added). Neither Prudential's first mortgage nor any other document executed at closing placed any restriction on Prudential's ability to extend the time for HAC to make its mortgage payments.

In both the second and third mortgages, Youmans expressly acknowledged that his rights were "subordinate and inferior" to Prudential's first mortgage:

> **1.02** ***Warranty Of Title***. . . . [Youmans] hereby agrees and acknowledges that the **lien hereof and security interest arising hereunder are subordinate and inferior to all right, title, and interest of The Prudential Insurance Company of America** arising under this certain note and mortgage executed by [HAC] this date, and securing the principal sum of Six Million Dollars ($6,000,000).

(emphasis added). Of course, Prudential's mortgage is superior to the Youmans mortgages not only by virtue of this provision, but also by operation of law because Prudential recorded its mortgage first. (S.C. § 30-7-10).

Approximately one year after closing, the hotel encountered financial difficulties and HAC requested an extension of time to make its mortgage payments. Pursuant to the express authorization of paragraph 30 of its first mortgage, Prudential granted HAC a six-month extension. Following this forbearance, HAC resumed its payments, but later fell into arrearage once again. Prudential then declared a default and gave Youmans, as holder of the subordinate mortgages, an opportunity to cure the default and take over the property.

Although Youmans had the funds to cure, Youmans refused to do so, stating that Prudential had improperly extended HAC's time for payment, had waited too long to declare a default, and that it would be "commercially unreasonable" to cure at that time. Youmans took the position that paragraph 9(e) of Prudential's Loan Commitment Letter to HAC - *signed seven weeks before closing and never incorporated into any of the closing documents* - contained a provision requiring Prudential to give him notice of a default and an immediate opportunity to cure; Youmans maintained that paragraph 9(e) of the Commitment Letter was a "part of" the final closing documents even though it did not appear in any of the closing documents, even though it was not omitted by fraud or mistake, and even though numerous provisions of the Commitment Letter were inconsistent with his own mortgages. Notwithstanding these undisputed facts, Youmans based his breach of contract claim on paragraph 9(e) of the Commitment Letter. (Count I).

Youmans argued that Prudential's obligation to notify him and to give him an immediate opportunity to foreclose under his subordinate notes existed not only by virtue of contract but also because Prudential owed Youmans, as subordinate mortgagee, a generalized common law "duty" to give immediate notice of HAC's first missed payment and an opportunity to cure. This was the basis of Youmans' negligence claim (Count VII).

The trial court erroneously allowed both claims to go to the jury and a verdict against Prudential was returned in the sum of $100,000 on the breach of contract claim, $1,000,000 on the negligence claim and $500,000 in punitive damages on the negligence claim.[1] The jury, however, returned a verdict in favor of Prudential on Youmans' fraud claims. On appeal, the Fourth Circuit reversed the trial court's denial of Prudential's JNOV on both the contract and negligence claims and entered judgment in favor of Prudential as a matter of law. The Fourth Circuit correctly found that under South Carolina's well-established "merger doctrine," Prudential's Commitment Letter could not form the basis of a breach of contract claim because it was not a term in the final contract. The Fourth Circuit held that the documents executed at closing represented the final and binding expression of the parties' intentions, not the documents executed before closing.

The Fourth Circuit also ruled that Prudential was entitled to judgment as a matter of law on Youmans' negligence claim because South Carolina does not recognize a generalized "duty" on the part of first mortgagees to notify subordinate lienholders when their borrowers miss mortgage payments, nor do they owe a duty to give subordinate lienholders an immediate opportunity to cure any such missed payments. Furthermore, the court held that paragraph 30 of the mortgage "clearly gave Prudential the right 'without notice or consent' to enter into an agreement waiving or extending HAC's terms under the mortgage." (Petitioner's App. 14). The Fourth Circuit's decision was correct, therefore, for the additional reason that the mortgages expressly authorized Prudential to do what it did and Youmans specifically acknowledged and agreed to be bound by Prudential's first mortgage. To reach this conclusion, the Fourth Circuit merely followed South Carolina contract law and enforced the plain meaning of the contracts.

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[1] The Honorable David C. Norton was appointed to the federal district court on August 13, 1990 and this case was transferred to him shortly before jury selection began in January 1991.

Youmans now petitions this court for a writ of certiorari on the purported grounds that the Fourth Circuit violated the *Erie* Doctrine by failing to follow South Carolina law and also violated the Seventh Amendment by improperly re-weighing factual issues on appeal. Although the Petitioner has strained to cloak the questions presented in terms of "*Erie*" and Seventh Amendment violations, it is painfully obvious that the case does not raise any federal question, does not present any issue of special significance, and does not reach beyond the specific facts of this case or present any legal conflict in South Carolina law. The Fourth Circuit merely affirmed that the rights of a subordinate mortgagee (i.e., Youmans) are subordinate and inferior to the terms of a prior recorded first mortgage and that under South Carolina's "merger doctrine" a mortgage supersedes a commitment letter and represents the final, binding expression of the parties' intentions. In fact, when denying Youmans' Motion for Certification to the South Carolina Supreme Court, the Fourth Circuit specifically concluded that "**resolution of the issues [is] clear under existing South Carolina case law.**" (Petitioner's App. 5, fn. 2) (emphasis added).

Statement Of Facts

In the fall of 1983, Dr. Youmans decided to sell the Francis Marion Hotel. He began soliciting offers from hotel management companies, private investors, and potential purchasers throughout the country. On September 19, 1984, Youmans entered into a Purchase Agreement with Hecht & Stoler, Inc. ("H&S"), a New Jersey corporation that was experienced in the hotel management business. The Purchase Agreement contemplated a total sales price of $10,050,000, with H&S paying Youmans $7,500,000 in cash and executing two non-recourse promissory notes in favor of Youmans for the balance of the purchase price. In order to give them time to satisfy the conditions set forth in the Purchase Agreement and to prepare final closing documents, H&S and Youmans planned to "close" the sale sometime before December 20, 1984.

The Purchase Agreement of course did not set forth all of the specific details of the transaction. Many items were left to negotiation and were to be completed before closing. For example, Hecht & Stoler, Inc. was not the entity that actually purchased the hotel. Prior to closing, H&S assigned its interest in the Purchase Agreement to Hospitality Associates of Charleston ("HAC"), a New York limited partnership that Messrs. Hecht and Stoler, as general partners, formed in October of 1984 after H&S executed the Purchase Agreement.

HAC Applies For A $6,000,000 Loan From Prudential

Perhaps the most important condition that H&S (i.e., HAC) had to satisfy under the Purchase Agreement was to obtain primary financing for its $7,500,000 cash payment. For this purpose, HAC submitted a loan application to Prudential's mortgage division for a first priority loan in the principal amount of $6,000,000, which HAC intended to supplement with an additional $1,500,000 from limited partnership investors. On October 26, 1984, Prudential approved HAC's loan application and issued a commitment letter agreeing to make a $6,000,000 first mortgage loan, subject to HAC satisfying certain conditions prior to closing and preparation of mutually acceptable mortgage documents.

In the interim between the execution of the Purchase Agreement and the anticipated closing date, HAC independently negotiated with Youmans and with Prudential over the various items that would be included in the final version of the escrow agreements, notes, mortgages, and multiple other Closing Documents (hereinafter collectively "Closing Documents"). During this period, at least two real estate lawyers who specialized in real estate transactions of this type represented each of

the parties. The following is a list of the attorneys who negotiated on behalf of the parties:

Youmans:	M. Craig Garner, Esq. (McNair Law Firm) and Sandra Randelman, Esq. (McNair Law Firm)
HAC:	Martin Kroll, Esq. (Snow, Becker, Kroll & Krause) and Mark Borten, Esq. (Snow, Becker, Kroll & Krause)
Prudential:	William Bates, Esq. (Young, Clement, Rivers & Tisdale) and Randall Stephens, Esq. (Prudential In-House Counsel)

These lawyers, with their clients' active participation, negotiated and drafted the final Closing Documents.

Prior to closing, the parties made many changes to the documents that were outlined in the Purchase Agreement and in Prudential's Commitment Letter. It would be impractical to list each of the differences but the following are a few examples of the changes that occurred in Prudential's Commitment Letter:

- Paragraph 9(e) of Prudential's Commitment Letter states that all interest under the second and third notes shall accrue and not be due during the first two years. Yet, the second note did accrue interest during the first two years to the extent that the hotel generated a profit and the third note began accruing interest immediately.
- Paragraph 9(e)(i) of the Prudential Commitment Letter stated that Prudential would give Youmans an opportunity to cure HAC's defaults within thirty

days of a written demand by Prudential. Yet, this provision did not appear in the Closing Documents.

- Paragraph 6(i) of the Commitment Letter provided that Prudential would receive, at closing, "an irrevocable and unconditional Letter of Credit in the amount of $235,000" to guaranty the first year's mortgage payments and management fees. Yet, Prudential did not receive such a Letter of Credit.

- Paragraph 2(b) of the Commitment Letter provided that Prudential would receive a perfected security interest in the hotel's furniture, fixtures, and equipment. Yet, the final Closing Documents did not give Prudential a perfected security interest in the FF&E.

- Paragraph 2(b) of the Commitment Letter provided that Prudential would receive a Surety Bond to secure payment of rent due under certain leases. Yet, Prudential did not receive such a Surety Bond at closing.

- The Commitment Letter did not contemplate the establishment of a $950,000 escrow account to guarantee lease payments for the hotel furniture. Yet, it is undisputed that as part of a last minute arrangement, the parties established a special escrow account to secure payments for the hotel furniture.

In short, the parties and their counsel made many changes to the original Purchase Agreement as well as to the Commitment Letter.

Although the parties drafted additional documents as new, unexpected issues arose and although many negotiated changes were made in the preliminary Closing Documents, both Youmans and HAC intended for the documents that they planned to execute at closing to represent the final, binding expression of their agreement. Paragraph 8(b)(iii) of the Purchase Agreement reflects this intention:

> **Consummation of the Closing shall constitute an acknowledgment of both parties** that all exhibits required to be attached to this agreement are acceptable, except as may be provided otherwise in writing, and **that all conditions precedent to the obligations arising hereunder have been duly performed or waived.**

(emphasis added). Thus, the parties agreed that the documents executed at closing would represent the final contract and that terms from earlier drafts would not survive unless they actually appeared in the Closing Documents.

The Sale Closes

On December 12, 1984, HAC, Youmans, and Prudential attended a day-long closing in Charleston at the law offices of Buist, Moore, Smyth & McGee. The closing represented the culmination of several months of extensive bargaining and negotiations between Youmans and HAC over the terms of the final sales documents and, to a lesser extent, negotiations between HAC and Prudential over the terms of Prudential's first mortgage. As with any scheduled real estate closing, all of the parties had an opportunity to examine, review, and approve the final Closing Documents well in advance of, and during, closing.

The sale closed as planned. Prudential delivered a $6,000,000 purchase money check to HAC and received a promissory note secured by a first mortgage on the hotel. HAC added this loan amount to the $1,500,000 it had raised from its limited partners to pay Youmans $7,500,000 in cash. For the remainder of the total purchase price, HAC delivered two promissory notes to Youmans, both of which Youmans secured with mortgages on the property and which were expressly subordinate and subject to the terms of Prudential's first mortgage.

Prudential's First Mortgage

The monthly payment on Prudential's first promissory note was $72,250. Paragraph 30 of Prudential's first mortgage specifically provided that Prudential could unilaterally extend the time for HAC to make its mortgage payments without obtaining Youmans' prior consent:

> **30. ACTIONS BY MORTGAGEE:**
>
> a. Without affecting the liability of [HAC] for payment of any indebtedness secured hereby or for performance of any obligation contained herein, . . . [Prudential] may, at any time and from time to time, either before or after the maturity of said note, and **without notice or consent:**
>
> **(i) release any person liable for payment of all or any part of the indebtedness or for performance of any obligation.**
>
> **(ii) make any agreement extending the time or otherwise altering the terms of payment of all or any part of the indebtedness** or modifying or waiving any obligation, or subordinating, modifying or otherwise dealing with the lien or charge hereof.
>
> **(iii) exercise or refrain from exercising or waive any right [Prudential] may have.**

(emphasis added). Thus, paragraph 30(a)(ii) of Prudential's first mortgage specifically authorized it to grant HAC extensions of time for making payments on the first mortgage "without notice or consent" to or from any other party.

It is undisputed that Youmans and HAC — as well as their lawyers — reviewed and approved Prudential's first mortgage. *It is also undisputed that Prudential's first mortgage did not contain a provision requiring Prudential to notify Youmans of missed payments under the first mortgage or to obtain permission from Youmans before granting HAC extensions of time for payment.* To the contrary, paragraph 30 of Prudential's mortgage authorized Prudential to extend the time for payment without notice to, or the

consent of, any other party. The second and third mortgages placed the burden on HAC, *not Prudential*, to notify Youmans of defaults under the first mortgage. No document signed at the closing or at any other time purported to require Prudential to give Youmans or anyone else prompt or immediate notice of HAC's missed payments.

Youmans' Second And Third Mortgages

Youmans' second and third mortgages both acknowledged that they were "subordinate and inferior" to Prudential's first mortgage. Paragraph 1.02 of Youmans second and third mortgages contain the following provision:

> 1.02 *Warranty of Title*. . . . [Youmans] hereby agrees and acknowledges that the lien hereof and security interest arising hereunder are subordinate and inferior to all right, title, and interest of The Prudential Insurance Company of America arising under the certain note and mortgage executed by [HAC] this date, and securing the principal sum of Six Million Dollars ($6,000,000).

Thus, in addition to the priority given Prudential's first mortgage by operation of law (S.C. §30-7-10), Prudential's first mortgage was superior to the second and third mortgages because both mortgages contained provisions expressly recognizing its priority.

The second and third mortgages also contain provisions requiring HAC to notify Youmans if HAC defaulted under Prudential's first mortgage and if the default was not cured within "any applicable grace period." Both the second and third mortgages contain the following "cross-default" provision:

> 2.01 *Event of Default.* The term "Event of Default" wherever used in this Mortgage, shall mean any one or more of the following events:
>
> * * *

> (d) Default by [HAC], which is not cured within any applicable grace period, (A) under any instrument creating a lien on or a security interest in all or any portion of the Mortgaged Property, or (B) under any agreement or obligation of [HAC] affecting all or any portion of the mortgaged property. **[HAC] shall notify [Youmans] in writing promptly upon the occurrence of each such default, specifying the nature of such default.**

(emphasis added). Thus, paragraph 2.01(d) of Youmans' second and third mortgages required HAC to notify Youmans of any default under the first mortgage that was not cured within any "grace period" that Prudential might extend.

HAC Experiences Financial Problems
After One Year Of Operation

In November of 1985 — after approximately one year of operating the hotel — HAC notified Prudential that occupancy levels had been lower than expected and that it would have difficulty making timely mortgage payments. Because occupancy levels vary with the season, HAC requested that it be allowed to defer its mortgage payments until after the slow winter months had passed. Consistent with Prudential's long-standing policy of working with its borrowers and not blindly declaring a default immediately upon a missed payment, Prudential met with HAC in January of 1986 and, pursuant to paragraph 30 of its first mortgage, agreed to defer HAC's mortgage payments through June of 1986. Both HAC and Prudential believed that HAC could use the forbearance period to raise additional equity from limited partnership investors, which would enable the hotel to become competitive and generate sufficient income to make its monthly mortgage payments.

The forbearance initially worked. In July of 1986, HAC began making its monthly payments and was able to stay current through the end of the year. In January of 1987, however, HAC again began missing its payments and, despite further attempts

to raise equity, failed to generate enough income to make its mortgage payments for the first four (4) months of 1987. HAC made its May payment, but after failing to make its June payment, Prudential declared a default. At the time Prudential declared a default, HAC's monthly payment history was as follows:

Dec. '84 thru Oct. '85	Payments made
Nov. '85 thru June '86	Payments deferred
July '86	Payments made
Aug. '86	Payments made
Sept. '86	Payments made
Oct. '86	Payments made
Nov. '86	Payments made
Dec. '86	Payments made
Jan. '87	Missed payments
Feb. '87	Missed payments
Mar. '87	Missed payments
April '87	Missed payments
May '87	Payment made
June '87	Missed payment; default declared

When Prudential declared a default, HAC had missed its June payment and had missed a total of five (5) payments without Prudential's consent.

Prudential Gives Dr. Youmans An Opportunity To Cure HAC's Defaults

Prudential contacted Dr. Youmans and told him that Prudential had declared a default and intended to initiate judicial foreclosure proceedings against the property. Prudential extended to Dr. Youmans an opportunity to cure by paying the

outstanding arrearage on HAC's mortgage. In response, Dr. Youmans informed Prudential that, despite receiving monthly financial statements, he had not known about the hotel's poor financial condition, nor had he known about HAC's inability to make timely mortgage payments to Prudential. He stated that Prudential had wrongly failed to give him "prompt and immediate" notice of HAC's missed mortgage payments and had wrongly extended the time for HAC to make its payments without obtaining his consent and giving him an immediate opportunity to cure.

When specifically questioned about his alleged "right to immediate notice", Dr. Youmans' attorney produced a copy of Prudential's October 26, 1984 Commitment Letter — *dated seven (7) weeks before the parties had executed the Closing Documents*. Paragraph 9(e)(i) of the Commitment Letter stated as follows:

> (e) *Additional Financing*
>
> The Mortgaged Premises shall not be encumbered by any secondary or subordinate liens, except for a second mortgage loan in the principal amount of $2,550,000, and a third mortgage loan in the original principal amount of $1,000,000, the second and third mortgages both having a term of seven years and with all interest accrued and not due during the first two years. . . . Prudential also agrees as follows:
>
> (i) that, in the event of a monetary default under the Prudential first mortgage, Prudential will allow the second or third lienholder the right to bring the first mortgage current within thirty (30) days of written demand therefore by Prudential;

(Petitioner's App. 41). Youmans claimed that paragraph 9(e)(i) of the Commitment Letter gave him a right to receive immediate notice from Prudential of HAC's first missed payment and an

immediate opportunity to foreclose under his subordinate mortgages. Although paragraph 9(e)(i) discusses a right to cure within thirty days of Prudential's written demand, it does not obligate Prudential to give prompt and immediate notice of a default; HAC, not Prudential, had the obligation to notify Plaintiffs of any default that was not cured within "any applicable grace period."

Additionally, *it is undisputed that paragraph 9(e)(i) of the Commitment Letter did not appear in any of the Closing Documents executed on December 12, 1984 and it is undisputed that neither paragraph 9(e)(i) nor the Closing Documents placed any restrictions on Prudential's ability to extend the time for HAC to make its loan payments.* It is also undisputed that Youmans did not comply with paragraph 9(e) of Prudential's Commitment Letter, which stated that interest under the second and third mortgages would accrue and not be due during the first two years. However, interest was due and payable under the second note during the first two years to the extent the hotel generated a profit and interest began accruing immediately on the third note.

Dr. Youmans Refuses To Cure And Prudential Forecloses

Although he had the financial ability to do so, Dr. Youmans refused to cure HAC's defaults, stating that it was "commercially unreasonable" for Prudential to expect him to pay the full arrearage. Because Dr. Youmans refused to cure, Prudential was forced to continue foreclosure proceedings against the property. Neither Dr. Youmans nor any other prospective purchaser bid on the property (although Dr. Youmans was present and had an opportunity to bid at the public auction) and Prudential subsequently obtained title to the property by Order dated October 14, 1988.

Youmans Files Suit

Approximately two (2) weeks before the court issued a final Order in the judicial foreclosure proceedings, Youmans filed suit against Prudential, HAC, Hecht, and Stoler. Six of the twelve

counts contained in the complaint were against Prudential: RICO, civil conspiracy, fraud, breach of contract accompanied by fraudulent act, breach of contract, and negligence. Although stated separately, each of the six claims against Prudential arise out of Youmans' single contention that Prudential failed to notify him immediately of HAC's missed payments and wrongly engaged in a workout with HAC by extending the time for HAC to make payments under the first mortgage, notwithstanding paragraph 30 of Prudential's first mortgage which expressly authorized payment extensions "without notice or consent" to any other party.

Prior to trial, the lower court dismissed Youmans' RICO claim against Prudential on the grounds that there was no "pattern of racketeering activity." At the close of the evidence, the court directed a verdict in favor of Prudential on Dr. Youmans' civil conspiracy claim, leaving only four counts for the jury. These claims and their disposition at trial were as follows:

	Claim	Verdict
1)	Negligence	$1,000,000 (actual damages) $ 500,000 (punitive damages)
2)	Breach of Contract	$ 100,000
3)	Fraud	verdict in favor of Prudential
4)	Breach of Contract Accompanied by Fraud	verdict in favor of Prudential

On appeal, the Fourth Circuit affirmed the judgment in favor of Prudential on the fraud claims and reversed the judgment against Prudential on the negligence and breach of contract claims.

Petitioner's Misstatements of Law and Fact

Although Youmans' Statement of the Case is misleading or incomplete to the extent it is contrary to the facts as stated above, Prudential specifically notes the following inaccuracies in his Petition pursuant to Supreme Court Rule 15.1:

1. Paragraph 30 of Prudential's Mortgage Specifically Provided that Prudential Could Unilaterally Extend the Time for HAC To Make its Mortgages Payments without Obtaining Youmans' Prior Consent and Youmans Specifically Agreed to this Condition.

Perhaps the most glaring inaccuracy in Youmans' Petition is its failure to disclose the terms of the three mortgages which control this case: that is, Prudential's first mortgage which expressly authorizes extensions of time for payment without notice to or consent from Youmans, and Youmans' own mortgages which expressly recognize that they are "subordinate and inferior" to the Prudential mortgage and which are inconsistent with the language of paragraph 9(e) of the Commitment Letter upon which he now relies.[2]

2. The Fourth Circuit Did Not Apply Massachusetts Law; In Fact, It Stated That the Issues Were "Clear Under Existing South Carolina Case Law" and Specifically Rejected Youmans' Request to Certify the Issues Raised in the Case to the South Carolina Supreme Court.

Youmans' entire Petition is based on the Fourth Circuit's alleged violation of the *Erie* doctrine by applying Massachusetts law to the facts of this case. This is simply wrong. The Fourth Circuit followed established South Carolina case law and, in fact, stated in its Opinion that **"We find resolution of the issues clear under existing South Carolina case law . . . ."** (Petitioner's App.

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[2] The priority of Prudential's mortgage was conclusively established by judicial decree during the foreclosure proceedings. In those proceedings, the court entered an order declaring Prudential's first mortgage superior to Youmans' mortgages.

5, fn. 2) (emphasis added). Youmans petitioned the Fourth Circuit to certify the issues raised in this case to the South Carolina Supreme Court. The Fourth Circuit rejected the motion because the application of South Carolina law was straightforward and unambiguous. If the Fourth Circuit had any reservations about South Carolina law or its application to the facts of the case, it would have certified the issues to the South Carolina Supreme Court. It did not, however, because there is no uncertainty.

3. The Closing Was Not "A Three Party Negotiated Transaction" and Prudential Was Not a "Co-Lender" with Dr. Youmans. (Petitioner's Brief, p. 3).

Despite Youmans' persistent mischaracterization to the contrary, Prudential was not a "co-lender" with Youmans. Prudential negotiated and dealt with its borrower and, in fact, never had any direct dealings with Youmans until the closing when the mortgages and related documents were signed.

4. The Commitment Letter Was Not "Part Of The Closing Documents". (Petitioner's Brief, p. 6-7).

Contrary to the plain, undisputed facts of the case, Youmans contends that the Commitment Letter was "part of the closing documents." (Brief, p. 6-7). This is simply wrong. *It is undisputed that the Commitment Letter was executed seven weeks prior to the execution of the final Closing Documents, and it is equally undisputed that neither paragraph 9(e) nor many other provisions of the Commitment Letter appeared in any of the final Closing Documents.*

Youmans vacillates between arguing, on the one hand, that paragraph 9(e) "never [was] required to be in any" of the Closing Documents (Petitioner's Brief, fn. 1) and arguing, on the other hand, that paragraph 9(e) "was required to be...part of the closing documents." (Petitioner's Brief, p. 6-7). Youmans' inability to hold steadfast to any single argument simply highlights the central, dispositive issue in the case: *the very contractual provision that Youmans' entire claim rests upon is not found anywhere in the final contract.* Properly applying established South Carolina "merger" law, the Fourth Circuit merely held that, in the

absence of fraud or mistake, Youmans could not rely on a term that did not appear in the final contract. *See, e.g., Wilson v. Landstrom,* 281 S.C. 260, 315 S.E.2d 130 (Ct. App. 1984).

5. Prudential Did Not Declare a Default in November of 1985. (Petitioner's Brief, p. 10).

Youmans argues that when he first received notice of Prudential's intent to foreclose, HAC had been in default for "twenty-two (22) months (since November 1985)." This is simply not true. As noted above and as correctly stated in Chief Judge Irvin's Opinion, HAC had sporadically made payments over the year prior to when Prudential declared a default. (Petitioner's App. 9). In fact, when Prudential declared the default in June of 1987, HAC's last payment had been in May of 1987.

6. Youmans' Reference to *West v. American T & T Co.*, 311 U.S. 223 (1940) on Page 19 of its Brief is Inaccurate and Misleading.

Youmans cites *West v. American T & T Co.,* 311 U.S. 223 (1940) for the apparent proposition that South Carolina has somehow modified its merger law with respect to multiple party transactions. (Petitioner's Brief, p. 19). This is wrong. *West* came to this Court from the Ohio Court of Appeals and, furthermore, did not even address the doctrine of merger.

SUMMARY OF ARGUMENT

Youmans' entire negligence claim rested upon Prudential's allegedly wrongful decision to extend the time for its borrower to make a payment. The Fourth Circuit properly ruled in Prudential's favor as a matter of law on Youmans' negligence claim because paragraph 30 of Prudential's first mortgage expressly authorized Prudential to extend the time for its borrower to make payments without notice to or consent from Youmans and Youmans specifically agreed to this provision. The Fourth Circuit properly ruled in Prudential's favor on Youmans' negligence claim for the additional reason that South Carolina does not recognize a generalized "duty" on the part of first mortgagees to

notify subordinate lienholders when their borrowers miss payments. Nor do first mortgagees owe a duty to give subordinate lienholders an immediate opportunity to cure any such missed payments.

The Fourth Circuit also correctly entered judgment in favor of Prudential on Youmans' breach of contract claim. Under South Carolina's well-established "merger doctrine", the court held that Prudential's Commitment Letter — signed seven weeks before closing and never incorporated into any of the final closing documents — could not form the basis of a breach of contract claim. (Petitioner's App. 10-15). *See also, Wilson v. Landstrom,* 315 S.E.2d 130 (S.C. App. 1984).

The issues raised in the Petition do not present any special or important issues meriting this Court's discretionary review. At best, the case raises a fact specific challenge to the application of South Carolina law dealing with issues that reach no further than beyond the individual litigants in this case. The case does not involve a conflict with the decision of any other United States Court of Appeals, does not raise a federal question, and does not represent anything more than the Fourth Circuit's straight-forward application of South Carolina law to the facts of this case. Youmans' characterization of the issue in this case as involving an "*Erie* violation" is nothing more than a thinly veiled attempt to create the false impression that the case involves issues requiring resolution in this Court.

REASONS FOR DENYING THE WRIT

I. THIS COURT SHOULD DECLINE TO GRANT CERTIORARI TO REVIEW A FACT-SPECIFIC DECISION OF THE FOURTH CIRCUIT THAT MERELY APPLIES ESTABLISHED SOUTH CAROLINA LAW.

Youmans argues that the Fourth Circuit failed to apply South Carolina law in violation of 28 U.S.C. § 1652 and *Erie Ry*

Co. v. Tompkins, 304 U.S. 64 (1938). Youmans makes this argument with respect to the Fourth Circuit's reversal of both the negligence and breach of contract verdicts.

A. Negligence: The Fourth Circuit Did Not Apply Massachusetts Law and Did Not Violate The *Erie* Doctrine.

Citing *Shipes v. Piggly Wiggly St. Andrews, Inc.,* 238 S.E.2d 167, 168 (S.Ct. 1977), the Fourth Circuit correctly noted that the question of whether a duty exists is one of law for the Court. (Petitioner's App. 16). In Part II B of its Opinion, the Court concluded that Youmans had not identified any duty that Prudential had even arguably breached. In fact, Youmans still has not cited a single South Carolina case that supports any of the alleged duties that would be applicable to the facts of this case.

Youmans argues that the Fourth Circuit applied Massachusetts law. This is not correct. The Fourth Circuit merely responded to Youmans' arguments by noting that under South Carolina law there is no authority to support the existence of a general common law duty for superior mortgagees to notify subordinate mortgagees before extending the time for their borrowers to make payment. To this date, Youmans has not cited the Court to any authority that would support the existence of such a general common law duty. Moreover, even if such a duty did exist (and it does not), it would not apply in the facts of this case because Youmans' own mortgages expressly waive any right to notice of or consent to the extensions.

Youmans' argument that the Fourth Circuit followed Massachusetts law is classically a straw man argument. After noting that no South Carolina law supports Youmans' argument, the Fourth Circuit cited two cases in other jurisdictions that have addressed the issue and specifically held that *no* such duty exists. *See, e.g., Avondale Shipyards, Inc. v. Tank Barge, Ets,* 2303, 754 F.2d 1300, 1308 (5th Cir. 1985), citing *Guleserian v. Fields,* 218 N.E.2d, 397, 401-02 (Mass. 1966). The Fourth Circuit did not, however, "follow" Massachusetts law. It held that Youmans had cited no apposite authority and cited cases from other jurisdictions for the "universal rule" that no such duty exists.

Avondale and *Guleserian* certainly are not anomalies. Every court that has addressed this issue has held that, in the absence of an agreement to the contrary, purchase money mortgagees can extend to their borrower's time for payment without obtaining the consent of subordinate mortgagees. *See, e.g., Miami Real Estate Co. v. Baxter,* 98 Fla. 900, 124 So. 452 (1929) (when one acquires a lien on property already encumbered by a mortgage, he does so subject to the possibility that the lien of the mortgage may be extended beyond the original maturity date or that the terms of the indebtedness may otherwise change); *Crutchfield v. Johnson & Latimer,* 243 Ala. 73, 8 So.2d 412 (1942) ("[t]he extension of time of payment . . . did not impair the security of appellees as subsequent encumbrancers"); *State Life Ins. Co. v. Freeman,* 308 Ill. App. 127, 31 N.E.2d 375, 381 (1941) ("the extension of the time of payment of a mortgage in no way impairs the mortgage lien as against subsequent encumbrancers or as against any other parties subsequently dealing with the title"); *Beckman v. Altoona Trust Co.,* 332 Pa. 545, 2 A.2d 826 (Pa. 1938) ("[t]he universal rule is that the extension of the time of payment of a mortgage debt . . . does not impair its priority or standing as a lien"); *Farmers & Merchants State Bank v. Hildebrandt,* 221 Wis. 394, 267 N.W. 42, 43 (1936) (an extension of time for payment of a first mortgage debt does not subordinate the lien to the lien of a second mortgage in the absence of intent to the contrary); *Hajek v. Pojar,* 126 Neb. 386, 253 N.W. 354 (1934) (second mortgagees cannot object to a first mortgagee's extension of time for payment); *Commonwealth Life Ins. Co. v. Louisville R.R.,* 234 Ky. 802, 29 S.W.2d 552, 556 (1930) ("[a]n agreement between a mortgagee and mortgagor for an extension of time for the payment of the indebtedness . . . is binding between the parties and against third parties whose rights are subordinate to those of the principal creditor").

Prudential's research has not revealed, and Youmans has not cited, a single case that requires a senior purchase money mortgagee (such as Prudential) to obtain the consent of a junior mortgage holder before extending the time for payment. Given the absence of any such authority and particularly given that Youmans expressly consented to the extension of time, the

Fourth Circuit correctly ruled that Prudential could not be liable in negligence.

"It is difficult to pin down exactly what duty Youmans asserts that Prudential owed to him." (Petitioner's App. 16). This statement was true when Chief Judge Irvin said it in his Opinion, and it is still true. In his Petition to this Court, Youmans has taken a shotgun approach and has attempted to identify four (4) common law duties that are allegedly applicable in this case. Youmans' exposition of common law duties, however, is entirely inapplicable to the facts of this case and Youmans has failed to identify any duty that Prudential owed Youmans in the context of this transaction that Prudential arguably breached.

Youmans alleges the existence of four common law duties, none of which would change the Fourth Circuit's analysis:

1. Senior Mortgagees Do Not Owe Subordinate Mortgagees a "Duty" to Obtain Their Consent Before Extending The Time For Their Borrowers To Make Payment.

Youmans relies on *Citizens & Southern National Bank of S.C. v. Smith,* 277 S.C. 162, 284 S.E.2d 770 (1981) to support his argument that a first mortgagee cannot extend the time for its borrower to make payments without first obtaining the consent of subordinate mortgagees. Even a cursory review of *Smith* shows that it is inapplicable to the issue presently before the court. In that case, the respondent seller sold his land to developers and received a purchase money mortgage in return. In order for the purchasers to obtain a $250,000 loan to develop the land, the seller agreed to subordinate his mortgage to the C&S Bank for a period of three (3) months. The subordination agreement stated that the seller would subordinate his mortgage, *provided that the purchasers pay the C&S Bank loan within three (3) months. Id.* at 771. As a result of the voluntary subordination, C&S Bank loaned the developers the $250,000 to develop the land. C&S Bank subsequently extended the developers' time for payment for one year beyond the agreed upon three months without obtaining the seller's consent. *Id.* When determining the priority

of the mortgages at judicial foreclosure, the court held that the seller's mortgage reverted back to its original priority because, contrary to the subordination agreement, C&S Bank had extended the time for payment without the seller's consent.

Smith is unavailing for several reasons. First, unlike the seller in *Smith*, Dr. Youmans never held a first mortgage. Prudential always had priority because it held a first purchase money mortgage; HAC used the $6,000,000 loan to purchase the hotel. The C&S Bank's loan in *Smith*, however, was for the purpose of developing the land, not purchasing it. Consequently, the seller's mortgage had natural priority and he voluntarily subordinated his mortgage on the condition that the C&S Bank mortgage would be paid within three months. When C&S Bank extended the purchasers' time for payment by one year, it breached a condition of the subordination agreement and the mortgages simply reverted to their original order of priority. Thus, there was a specific contractual limitation in *Smith* on the right to extend the time for payment without the seller's consent. In stark contrast, no such contractual limitation exists in the present case. *See also, Bulldog Properties v. Firstart,* 301 S.C. 336, 391 S.E.2d 871 (Ct. App. 1990), distinguishing *Smith* on same grounds.

Second, the mortgages in *Smith* did not contain a provision similar to paragraph 30 of Prudential's mortgage, which authorized extensions of payment without the consent of any other party. The *Smith* court was very careful to point out that C&S Bank reverted to its secondary position because it had modified the loan "without the knowledge and consent of the seller . . . ." *Id.* at 772. In the present case, Youmans consented to the extensions of time for payment. Paragraph 1.02 of Youmans' second and third mortgages state that they are "subordinate and inferior" to Prudential's first mortgage. Thus, Youmans is charged with knowledge of all the terms and conditions of Prudential's first mortgage, including paragraph 30, by contract as well as by operation of law. *See* S.C. § 30-7-10.

Third, *Smith* involved an equitable subordination in the context of a foreclosure proceeding, not a subsequent claim for

damages against a lienholder whose first mortgage priority had been conclusively established.

2. Senior Mortgagees Are Not In A Fiduciary Relationship With Subordinate Mortgagees.[3]

Youmans argues that a "fiduciary relationship" exists simply because Prudential and Youmans loaned money to the same borrower. Yet, on its face, this is an unbelievable contention, and the cases that Youmans cites certainly do not support it. To Prudential's knowledge, no court in the country has ever found that a fiduciary relationship exists between co-mortgagees in the absence of a specific agreement creating such a relationship. For example, in *American Realty Trust v. Chase Manhattan Bank, N.A.*, 222 Va. 392, 281 S.E.2d 825 (1981), the Court found that a fiduciary relationship existed by virtue of a specific agreement between two lenders when funding a single loan jointly. The Court specifically referenced the agreement in its decision ("[t]here can be no doubt that, **from the building loan agreement**, there arose a relationship between American and Chase as co-lenders"). *Id.* at 833. No such agreement exists in the present case. Furthermore, Prudential and Youmans did not fund the loan "jointly"; they were merely two mortgagees with an interest in the same property. Youmans' rights under his second and third mortgages were unquestionably subordinate and inferior to the rights of Prudential under its first mortgage, not only as a matter of law but also by express agreement in the mortgages themselves.[4]

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[3] Youmans refers to two alleged common law duties when making this argument. (Brief, p. 15-17). For purposes of Prudential's response, these duties are dealt with together.

[4] It is worthwile noting that Youmans argues that the Fourth Circuit violated *Eric v. Tomkins* by applying Massachusetts law. Yet, when advancing the bold argument that a fiduciary relationship exists between co-mortgagees, Youmans relies on *American Realty Trust v. Chase Manhattan Bank, N.A.*, 222 Va. 392, 281 S.E.2d 825 (1981), a Virginia case.

3. Senior Mortgagees Do Not "Assume" a Duty to Junior Mortgagees By Simply Exercising their Right to Engage in a Workout with their Borrowers.

Youmans argues that the Fourth Circuit failed to recognize that Prudential "assumed" a duty to Youmans by engaging in a workout with HAC. Youmans cites two cases to support its contention. *See, Caldwell v. Jim Walters Homes, Inc.*, 293 S.C. 229, 359 S.E.2d 518 (Ct. App. 1987); *Roundtree Villas Association v. 4701 Kings Court,* 282 S.C. 415, 321 S.E.2d 46 (1984). Neither of these cases, however, deal with liability to a *third person* for negligent performance of an assumed undertaking. Rather, both cases deal with liability to the person (not a third party) for whose benefit the duties were assumed. The cases involve the type of situation governed under Restatement (2d) of Torts Section 323, not Section 324 (A), which deals with liability to third parties. Section 324(A) deals with liability to third parties for assumed duties and Youmans has not even argued that it governs. In short, Youmans' cases are inapplicable because Prudential did not undertake to render any services to Youmans when it engaged in the workout with HAC.

Youmans' desperate attempt to identify a "duty" that will salvage his negligence claim is ineffectual for yet another reason: to reach its conclusion, the Fourth Circuit had to do no more than apply South Carolina contract law and enforce the intent of the parties as expressed in their mortgages. Regardless of any alleged duty, Prudential was entitled to judgment because Youmans agreed to be bound by paragraph 30 of Prudential's mortgage.

Despite hollow cries of an *"Erie"* violation, Youmans has done nothing more than restate the arguments that he made before the Fourth Circuit in his initial Brief, in his Motion for Rehearing, in his Suggestion for Rehearing in Banc, and in his Motion to Certify these issues to the South Carolina Supreme Court. Yet, the Fourth Circuit, after reviewing literally hundreds of pages of briefs, rejected these arguments, stating that *"we find resolution of issues clear under existing South Carolina case law."* (Petitioner's App. 55. fn. 2). For this reason as well as Youmans'

inability to articulate the duty that Prudential allegedly owed and breached, the Petition should be denied.

B. Breach of Contract: The Fourth Circuit Properly Applied South Carolina's Merger Doctrine.

In Part II A of its Opinion, the Fourth Circuit followed established South Carolina law as stated in *Wilson v. Landstrom,* 281 S.C. 260, 315 S.E.2d 130 (Ct. App. 1984) and held that "[m]ortgages delivered and accepted at closing, not the prior contract, represent the final bargain of the parties." In light of the Fourth Circuit's well-reasoned application of South Carolina law, Youmans' *Erie* violation argument with respect to the contract claim is particularly far reaching. Youmans acknowledges that the Fourth Circuit followed South Carolina law; he simply disagrees with that application. Certainly, this is not an appropriate subject of appellate review in this Court. Youmans argues that the Court should take an expansive view of the merger doctrine by finding that the Commitment Letter became "a part of" the final Closing Documents. As a matter of law, common sense, and public policy, Youmans cannot sustain this argument. Literally thousands of commercial real estate transactions are "closed" each day, and it would predictably lead to chaos if the Fourth Circuit were to deviate from the South Carolina Supreme Court's established rule and accept the argument that sales contracts, commitment letters, and the like — all of which are executed months before closing — survive closing, particularly where the parties expressly covenant that closing is the final expression of the parties' intentions.

Youmans relies on *Bishop Realty & Rentals v. Perk, Inc.,* 292 S.C. 182, 355 S.E.2d 298 (Ct. App. 1987) to argue that the Commitment Letter is "part of" the final contract. This case was argued at length in the court below and is unpersuasive. In *Bishop*, the court refused to enforce a subsequent contract concerning a real estate broker's commission because the broker did not participate in or consent to the modification. There was no evidence that the broker ever knew or "assented to . . . the second contract." *Id.* at 301.

Youmans apparently cites *Bishop* to contend that the Court should enforce Prudential's Commitment Letter and not the subsequently executed Closing Documents because he did not consent to the final closing documents. Youmans cannot sustain this contention. Unlike the real estate agent in *Bishop,* it is undisputed that Youmans participated in the closing and it is similarly undisputed that Youmans' second and third mortgages specifically "assented to" Prudential's first mortgage, which authorized Prudential to extend the time — without Youmans' consent — for payment. *Bishop,* therefore, is inapplicable.

II. THIS COURT SHOULD DECLINE TO DETERMINE WHETHER THE FOURTH CIRCUIT "REWEIGHED THE EVIDENCE" BECAUSE THE COURT ENTERED JUDGMENT IN FAVOR OF PRUDENTIAL BASED SOLELY ON THE UNDISPUTED FACTS.

Youmans argues that the Fourth Circuit "reweighed the evidence" and deprived him of his Seventh Amendment right to a jury trial. The Fourth Circuit, of course, is fully aware that it is not a trier of fact. The Fourth Circuit Opinion is clearly a decision as a matter of law based on undisputed facts and does not reweigh the credibility of any witness.

As discussed at length in the court's Opinion and above, Prudential was entitled to judgment on Youmans' negligence and breach of contract claims as a matter of law based solely on the undisputed facts. Although Youmans correctly states that disputed factual issues raise jury issues, he has failed to identify any disputed fact that should have ever been submitted to the jury. The following are undisputed and, based on nothing more, entitled Prudential to judgment in its favor:

1. Prudential and HAC executed the Commitment Letter seven weeks before closing;

2. The provisions of paragraph 9(e) of the Commitment Letter did not appear in any of the final Closing Documents;

3. Prudential's first mortgage was superior and binding on Youmans' second and third mortgages by express agreement and by operation of law; and,

4. Paragraph 30 of Prudential's first mortgage expressly authorized Prudential to extend the time for HAC to make payments without notice to or consent from Youmans.

Based on these undisputed facts, the Fourth Circuit properly entered judgment in favor of Prudential as a matter of law. It did not "reweigh the evidence." It correctly applied South Carolina law.

CONCLUSION

For the foregoing reasons and on the authorities cited, this Court should decline to grant the Writ of Certiorari to the Fourth Circuit Court of Appeals because the questions presented to this Court were correctly decided under the applicable law of South Carolina and the questions do not present any issues that would merit this Court exercising its discretion to review the case.

Respectfully submitted this 4th day of March, 1993.

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